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Financial and Consumer Services Commission of New Brunswick
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Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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Dear Sirs/Mesdames:

Re: CSA Notice and Request For Comment – Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms)

We submit the following comments in response to the Notice and Requests For Comment (the "**Notice**") published by the Canadian Securities Administrators (the "**CSA**") on June 21, 2018 with respect to the amendments proposed to enhance the client-registrant relationship (the so-called "**Client Focused Reforms**") to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**") and Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**31-103CP**", together with NI 31-103, the "**Proposed Amendments**").

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Thank you for the opportunity to comment on the Proposed Amendments. This letter represents the general comments of certain individual members of our securities practice group (and not those of the firm generally or any client of the firm) and are submitted without prejudice to any position taken or that may be taken by our firm on its own behalf or on behalf of any client.

All references to parts and sections are to the relevant parts or sections of the applicable Proposed Amendment. Capitalized terms which are used but not defined in this letter have the meanings set out in the Notice.

General Comments

In general, and subject to our comments below, we are supportive of the CSA's decision to move away from the adoption of an overarching regulatory best interest standard as put forward in Consultation Paper 33-404 ("**CP 33-404**") in favour of more focused amendments that would require that registrants address conflicts of interest in the best interest of the client. While we are also generally supportive of the related requirement that registrants put a client's interest first when making a suitability determination, we believe that further clarification of the scope of the "client first" standard is required. This would help ensure that the expectations gap, which the CSA have identified as a key investor protection concern, is not further exacerbated by differential and conflicting interpretations of this standard in the marketplace.

We also believe that the CSA have made considerable progress in moving the Client Focused Reforms to a more principles-based framework than what was originally contemplated under CP 33-404. However, we remain concerned that, with each round of amendments to NI 31-103 and 31-103CP, the regulation of registrants has steadily become more prescriptive and rules-based. The increased level of granularity of the rules is challenging and costly for registrants to interpret and operationalize and continues to have a disproportionate impact on small to medium sized firms whose ongoing engagement, we would argue, is vital to preserving fair, efficient and competitive capital markets. The blurring of the lines between the rules-based requirements in the proposed amendments to NI 31-103 and the extensive rules-based guidance in the proposed amendments to 31-103CP may further magnify these compliance and operational challenges, especially for smaller firms. The Proposed Amendments, while prescriptive and detailed in terms of specific requirements that must be met are, at the same time, less clear in terms of providing concrete examples of how registrants can meet the new obligations.

We also appreciate the CSA's efforts to "make the Proposed Amendments scalable to fit registrants' different operating models and to preserve the technology-neutral stance of the Instrument." We understand that scalability measures may be difficult to apply with respect to conflicts of interest requirements. However, we wonder whether the policy objectives underlying the proposed changes to the KYC, KYP and suitability requirements could be more effectively achieved through a flexible, principles and risk-based standard that would more clearly allow each registrant to adapt its compliance systems and controls to the specific characteristics and risks of its own client-base, business model and product shelf.

We are concerned that the one-size-fits-all approach underlying many of the Proposed Amendments may lead to consolidation of market participants that is driven by regulatory factors rather than market-based factors. Furthermore, this approach may result in heightened barriers to entry for new and emerging managers and smaller registrants that often enhance innovation and competition in the marketplace and are crucial to fostering fair and efficient capital markets.

Conventional and emerging technologies (including for example, AI, blockchain and cloud-based and quantum computing applications) will present market participants with increasing opportunities to enhance business, operational and regulatory compliance systems, including during the transition period for the adoption and implementation of the Client Focused Reforms. As it stands, the granularity of the proposals will likely compel heavy investments by larger registrants to build out even more sophisticated proprietary IT architectures and compliance systems to respond to the detailed rule and guidance-based requirements. We are concerned that small to medium sized

registrants that have already heavily invested in their existing compliance infrastructures to keep up with other recent regulatory changes to NI 31-103 and 31-103CP and evolving regulatory expectations, will again be forced to invest comparably disproportionate levels of resources to materially rework their compliance systems, likely to the detriment of investment in technology to enhance other aspects of their business.

We therefore ask the CSA to consider recasting the Proposed Amendments into a more flexible principles and risk-based framework that would further allow all categories of industry stakeholders to keep up with a dynamic and rapidly evolving marketplace and the significant technology driven changes and opportunities that lie ahead. In addition, this type of approach would give real substance to the CSA's objective of preserving the technology-neutral stance of NI 31-103 and 31-103CP.

We are also concerned that in the interest of mitigating conflicts of interest and in regulating suitability considerations, the Proposed Amendments may disproportionately favour lower cost products. This could lead to a reduction in the range of available product options and ultimately to less favourable investor outcomes. We respectfully question whether it is appropriate for rulemaking to address pricing considerations where market dynamics already foster the development of lower cost product solutions (e.g., index-based products).

Finally, we refer to the report published by the Investor Office of the Ontario Securities Commission ("**OSC**") on March 29, 2017 entitled *Behavioural Insights* (Staff Notice 11-778, the "**Report**"). In the Report, the OSC recognized that identifying and applying the concept of behavioural insights in policy development enables regulators to better comprehend, diagnose and address ongoing problems leading to better investor and market participant outcomes. To the extent that the CSA have not already done so, we encourage the CSA to consider the application of the methodologies outlined in the Report to the Proposed Amendments.

Specific Comments

1. **Know Your Client ("KYC")**

Through some form of supplementary guidance, we recommend that the CSA acknowledge the challenges that most registered firms and registered individuals face in communicating with many clients on an ongoing basis. Subsection 13.2(4) of NI 31-103 requires registrants to make reasonable efforts to keep clients' KYC information current to meet their suitability determination obligations. According to the CSA's guidance in 31-103CP, registrants are expected to be "proactive in determining that KYC information is current." The CSA also note that updating KYC information means that "the registrant should review and refresh the information on record after having a meaningful and documented interaction with the client." Furthermore, in order to fulfill KYC obligations, the registrant must explain to the client the role of the client in keeping information current. The ability of a registrant to keep KYC information current assumes that a client would be willing and able to continuously provide all of the prescribed information in response to a registrant's request. However, the Proposed Amendments do not address the consequences to a registrant of a client's failure to respond or provide adequate information in response to attempts by a registrant to obtain the prescribed information. Clear guidance is needed for registrants dealing with situations where clients are either unable to provide requested information, choose not to provide information, or do not respond to repeated requests for information. It would also be helpful for the CSA to provide some form of safe harbour according to which a registrant would be deemed to have complied with its regulatory obligations where the registrant (i) takes reasonable efforts to obtain the required information; (ii) documents those efforts; and (iii) is still unable to obtain the information. Consistent with the mechanism contemplated in subparagraph 13.3(2.1)(c) with respect to the suitability determination, firms should also have the ability with respect to more sophisticated clients to obtain written or electronically recorded confirmation of the client's instruction to proceed with any required actions despite the client's failure to provide the requested information. This mechanism would help meet the expectation articulated in the Proposed Amendments that "firms establish, maintain, and apply KYC policies, procedures and controls" that are responsive to "their client's type of account and the nature of the relationship with their clients," among other considerations.

The proposed amendments to subsection 13.2(4.1) of NI 31-103 require a registrant to review and update the information collected about a client "if the registrant knows, or reasonably ought to know, of a significant change in the client's information." We question the extent to which a registrant should be monitoring their clients' activities to fulfill its KYC obligations, and request guidance in this regard. For example, it may be reasonable to expect that a registrant monitor a clients' social media accounts or other online activity to determine whether a significant change has occurred in the client's circumstances. However, this level of monitoring could be burdensome and resource intensive for many registrants, as well as intrusive for clients and could raise privacy concerns.

With respect to the process for determining what is a significant change in a client's information, we note that paragraph (4.1)(a) of section 13.2 requires a registrant to review the information collected under that section if, among other cases, the registrant knows, or reasonably ought to know, of a "significant change" in the client's information, whereas paragraph (4.1)(b) requires a registrant to update the information required under that section if, following the review of the information under paragraph (4.1)(a), there has been a "change" in the information. We respectfully submit that the CSA should amend paragraph (4.1)(b) of NI 31-103 by replacing "change" with "significant change" for the sake of consistency. To the extent that the CSA desire to have firms monitor for changes in a client's situation outside of normal course client interactions, we suggest that the CSA consider providing further guidance as to how to do so in practice, and whether the level, frequency and scope of such monitoring may vary with the size of the client's account (e.g., where client assets are below a certain monetary threshold), the level of activity of the account (active versus inactive) and the nature of the account (discretionary versus non-discretionary).

Proposed subparagraph 13.2(c)(v) requires that a registrant take reasonable steps to ensure it has sufficient information regarding a client's risk profile in order to meet its suitability obligations. The proposed guidance in 31-103CP discusses establishing a client risk profile that includes a consideration of how much risk a client is willing to take. The proposed guidance provides that a possible relevant factor in establishing a client risk profile is the client's "loss aversion or the tendency to prefer avoiding losses to realizing equivalent gains." We recognize the importance of an assessment such as this, however, we are concerned that it is not always possible to make such an assessment until after a client relationship has been established. We request the CSA recognize that a preliminary determination of risk tolerance at the outset may be difficult to establish.

2. Know Your Product ("KYP")

Subparagraph 13.2.1(1)(a)(iii) of the proposed KYP requires that a registrant not make any security available to clients unless it takes reasonable steps to understand "how the security compares to similar securities available in the market." The guidance in 31-103CP further states that as part of the KYP process, a firm must "consider the overall competitiveness of the security, as compared to a reasonable range of similar investment opportunities," and "must understand generally how securities of their related and connected issuers compare with similar securities available in the market," regardless of whether securities of unrelated or unconnected issuers are offered. We are concerned with the practical application of this requirement. Many issuers of exempt market securities have no obligation to publicly disclose information and view information about their products as proprietary and confidential, making a true comparison difficult in practice. Furthermore, this may be a difficult exercise where a firm offers a complex or novel product. We ask that the CSA provide further guidance in this regard.

We respectfully submit that the obligations relating to transfers of securities and client-directed trades seem disproportionate and may raise timing, operational and other implementation issues, and should be clarified. We recommend that these particular obligations be subject to waiver by a permitted client. In an institutional portfolio transition situation, transfers of securities portfolios by an institutional client from one registrant to another must generally be completed on an expedited basis. Significantly, the registrant from which a securities portfolio is being transferred will have been subject to KYP obligations in relation to that portfolio. The registrant to which the portfolio would be transferred should be permitted to proceed with an orderly and methodical review of the composition

of the portfolio and make informed recommendations or decisions to retain or dispose of the transferred in securities. Similarly, in the institutional context where buy-side research teams undertake extensive investment research on individual securities, the application of extensive KYP obligations to a client-directed trade may give rise to a number of unnecessary timing and execution issues.

In the proposed guidance under 31-103CP, the CSA states its expectation that "[f]irms must document their independent analysis of the security's structure, features, returns, risks and initial and ongoing costs of the security, as well as the impact of those costs." However, the precise nature and scope of this independent analysis are not entirely clear. Additional guidance or cross references to established industry guidelines such as the Investment Industry Regulatory Organization of Canada's guidance notice on *Best practices for product due diligence* (revised March 25, 2009) would be helpful.

3. Suitability Determination

We believe that greater clarity and guidance on when a registrant has satisfied the suitability determination and discharged the obligation to "put the client's interest first" is warranted. In providing this guidance, it would also be helpful for the CSA to provide some form of safe harbour according to which a registrant would be deemed to have complied with its regulatory obligations under specified conditions.

We respectfully recommend that the guidance on portfolio concentration in 31-103CP should clarify that a registrant's obligation to consider overall portfolio concentration is limited to the client's account at the firm, consistent with the requirements of subparagraph 13.3(1)(a)(v).

As noted above, we question whether it is appropriate for the CSA to prescribe the lowest cost product and influence cost considerations where, for example, it is stated in the Proposed Amendments to 31-103CP that "[u]nless a registrant has a reasonable basis for determining that a higher cost security will be better for a client, we expect the registrant to trade, or recommend, the lowest cost security available to the client in the circumstances that meets the requirements of subsection 13.3(1)." Registrants should have the ability to obtain informed waivers of this requirement in certain circumstances, for instance, where a client is seeking a particular overlay (e.g., ESG), strategy or product (e.g., glide path or target date retirement portfolios).

4. Conflicts of Interest

We respectfully submit that proposed section 13.4.2, requiring registrants to address "all" conflicts rather than only "material" conflicts, places unnecessary burdens on registrants and that a materiality threshold should be maintained. Prior to taking any steps to control a conflict, we recommend that part of the process should involve some level of evaluation as to whether a conflict could reasonably be expected to have an actual impact on a client. We further ask the CSA to consider whether this standard is necessary in the context of institutional clients.

Again, it would be helpful for the CSA to provide some form of safe harbour according to which a registrant would be deemed to have complied with its regulatory obligations under specified conditions.

We are concerned with the impact of the Proposed Amendments on registered firms that trade proprietary products. 31-103CP states that it is a conflict of interest for a registered firm to trade in or recommend proprietary products. The guidance provides that for registered firms that trade exclusively in or recommend proprietary products, the process of addressing conflicts of interest should include "conducting periodic due diligence on comparable non-proprietary products available in the market and evaluating whether the proprietary products are competitive with the alternatives available in the market." We submit that this guidance is unnecessary as a product's competitiveness

is market tested on an on-going basis and registered firms will naturally phase out "uncompetitive" products. We query how competitiveness is to be measured and whether competitiveness means a cost comparison in all instances. We further submit that the guidance is unclear about how this applies when a comparative analysis is not always possible for firms that offer complex or novel proprietary products for which no similar securities exist in the marketplace. Furthermore, proposed subsection 13.4.2(2) provides that "[a] registered firm must avoid any conflict of interest" that is not, or cannot be, addressed in the best interest of the client. We question whether avoidance is the only option and urge the CSA to indicate whether it is acceptable, for example, to proceed where a client acknowledges and consents to the use of proprietary products.

Subsection 13.4.5(5) of the Proposed Amendments states that a registered firm "must not rely solely on disclosure to address, in the best interests of the client, conflicts of interest." We respectfully request the CSA reconsider whether further action is necessary when registrants are dealing with "permitted clients" rather than retail clients.

5. Referral Arrangements

We acknowledge the CSA's interest in ensuring that individuals and firms that engage in registrable activities are appropriately registered and that referral arrangements are not used to avoid registration. However, prohibiting the payment of referral fees to all non-registrants goes beyond this and could impact legitimate arrangements between registrants and non-registrants that have not met the business trigger.

We respectfully submit that if the CSA is concerned that there are individuals or entities receiving referral fees that should be registered because they engage in registrable activities, then the CSA should take action against these persons under the existing rules rather than precluding all referral arrangements involving non-registrants.

Furthermore, we would respectfully request that the CSA consider permitting referral arrangements between a registrant and non-registrant in circumstances where the client is a "permitted client" or "accredited investor" that has received full disclosure of the referral arrangement and consents to such an arrangement.

With respect to limitations on referral fees in the new proposed section 13.8.1, there may be unintended consequences. For example, the proposed changes to referral arrangements could affect transition issues for retiring registrants that want to sell their client business in exchange for ongoing payment. The Proposed Amendments to 31-103CP indicate this kind of circumstance would be examined on a case-by-case basis. However, some guidance should be provided, including whether the retiring registrant would need to continue to be registered post-retirement.

6. Relationship Disclosure Information ("RDI")

In an effort to ensure that adequate disclosure is made to clients, proposed section 14.1.2 requires that a registered firm make certain information publicly available. We are concerned that this is broad and may encompass competitive and other sensitive information, and ask the CSA to consider whether the same goal could be achieved by providing information directly to a client before an investment decision is made. We question whether it is necessary to create an obligation to provide potentially competitive information to the public, and ask that registrants have some discretion with respect to whom they provide information. While subsection 14.1.2(2) provides an exception for products and services that are offered exclusively to "permitted clients", we ask that the CSA consider lowering that threshold to include "accredited investors", as these types of investors should be sufficiently sophisticated to request any information they may need before dealing with a registrant.

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Stikeman Elliott

Thank you for the opportunity to comment on the Proposed Amendments. Please do not hesitate to contact any of the undersigned if you have any questions in this regard.

Yours truly,

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